

# The Pizza inn inc.

1971 ANNUAL REPORT



### F. J. Spillman *President*

One of original founders in 1961, Mr. Spillman, 35, previously was in the employ of Boeing Aircraft and American National Insurance Company. In 1960, he entered the restaurant business with a small unobtrusive store front operation across from Southern Methodist University in Dallas. Named Pizza Inn, this evolved into the incorporation of The Pizza Inn, Inc.

### John W. Tenery *Executive Vice President*

During the mid-fifties Mr. Tenery, 40, was associated with Alamo Exterminating and Hardware Co., San Antonio, and then moved to Dallas where he joined Security Engineering Co. In 1955 he became self-employed and provided services to industry until joining Pizza Inn in 1961. Mr. Tenery rejoined Pizza Inn in his present position in September 1971.

### Larry G. Hood *Vice President, Finance*

Prior to joining Pizza Inn, Mr. Hood, 34, a CPA since 1965, was Division Controller of Bonanza International in Dallas. In 1970 he joined Pizza Inn as Controller and assumed his present position via promotion in 1971. He earned a B.B.A. degree at the University of Texas in Arlington and did graduate studies at Southern Methodist University, where he received a Masters degree in business administration.

### Raymond E. Kelly *Vice President*

After having attended Arlington State and the University of Texas, Mr. Kelly, 37, was self-employed in the grocery business. In 1965, he became Vice President and General Manager of Praetorian Corporation which operated a small chain of Pizza restaurants. In 1968, Pizza Inn purchased Praetorian Corporation and Mr. Kelly moved to Pizza Inn with that purchase. He became Vice President in 1970.

**Stephen F. Newton**  
*Secretary and Corporate Counsel*  
Completing undergraduate studies at Kansas State College of Pittsburg, Mr. Newton, 25, earned a B.S. in business administration and subsequently received his law degree from the University of Texas. Prior to joining Pizza Inn and assuming his present corporate title in 1971, he was associated for one year with United Technology Laboratories, Inc. in Garland, Texas.



**Directors and Officers** Standing, from left: Roy L. Wise, Sr.; John W. Tenery; John A. Spillman; Raymond E. Kelly. Seated, from left: Stephen F. Newton; F. J. Spillman; Larry G. Hood

### Directors and Officers

**F. J. Spillman\***  
Chairman of the Board, President  
and Chief Executive Officer

**John W. Tenery\***  
Executive Vice President

**Larry G. Hood**  
Vice President, Finance

**Raymond E. Kelly**  
Vice President

**Stephen F. Newton**  
Secretary and Corporate Counsel

**John A. Spillman\***

**Roy L. Wise, Sr.\***

*\*Director*

### Corporate Headquarters

The Pizza Inn, Inc.  
2930 N. Stemmons Freeway  
Dallas, Texas 75247

### Transfer Agent and Registrar

National Bank of Commerce  
1525 Elm Street  
Dallas, Texas 75201

### Corporate Attorney

Wynne Jaffe & Tinsley  
LTV Tower  
Dallas, Texas 75201

### Auditors

Ernst & Ernst  
Fort Worth, Texas



## To Our Shareholders:

The year 1971 was a period in which the company underwent some rather drastic changes. Such moves were basically the result of pressures related to financial and management problems.

Expansion objectives during the last year were restricted considerably for several reasons. Funds necessary for such expansion, as well as for general operating capital, were in short supply. The resulting liquidity problem necessitated our initiating some significant changes.

First, a reorganization and reduction at the management level was accomplished. A new team, with certain existing company personnel assuming new responsibilities, was formed to replace many of the previous members. Second, we moved out of the Mexican and German food service areas by closing all of the company-owned Pepe' Taco (Mexican) and two of our three der Chees N' Wurst (German) restaurants, and we disposed of our subsidiary engaged in meat preparation. Third, we discontinued our expansion program for Pizza Inns until a consolidation of our operating

position could be effected. Certain other Pizza Inns were sold.

Inasmuch as the closed Mexican and German operations were in leased facilities, the rental obligations related to the vacated buildings created unusual pressure on the company's finances. Management moved to reduce the burden of these expenses by attempting to sublease vacant properties as rapidly as possible.

Indeed, the past year was a most undesirable period in our corporate history. During the year, the company sustained a loss of \$.35 per share of Common Stock. However, this is now past history. Your management is of the opinion that much has been learned from these experiences and that your company will derive future benefits from the events of 1971.

### Outlook

On the positive side, the moves undertaken, as previously outlined, should provide the basis for a marked improvement in the company's operations. The new management organization is qualified for leadership in all facets of our field of endeavor. Cost reductions have been

accomplished in all areas, where possible, and more effective and sophisticated controls through electronic data processing and other methods have been established. Better working relationships with our vendors, suppliers and franchisees have been established.

In the opinion of management, your company has made a turnaround and we are pleased to report that most restaurant units — franchised and company-owned — are operating profitably. There are presently 79 company-owned units and 144 franchised facilities for a total of 223.

The corrective moves outlined above are yielding positive results. At this writing, Pizza Inn is experiencing approximately a 20 percent increase in volume — average per unit — as compared to volume recorded some nine months to a year ago. We believe that the serious financial problems that existed in 1971 have improved to the point where we will resume our profit objectives in 1972. Due to the stabilization of fixed costs we have reached the point where it is possible to increase the number of company-owned units significantly

while incurring only nominal additional overhead costs. Plans call for the opening of approximately 32 new franchised units in 1972 and a limited increase in the number of company-operated units in certain geographical areas where the company is presently operating.

Industry sources are optimistic over growth potential within the food service and restaurant fields. At this time, industry sources say \$30 billion is expended annually by persons who eat out. Projections are that within eight years (1980) the figure will have grown to \$80 billion on an annual basis. Your company anticipates that it will participate in this market growth.

Pizza Inn has established a recognized position within the specialized field in which it functions, and we expect your company to return to profitability during 1972.

Sincerely,

*39 Hillman*

President  
May 5, 1972



## Consolidated Balance Sheet

	December 31 1971	December 31 1970
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 92,016	\$ 456,361
Certificates of deposit	3,368	43,368
Receivables:		
Trade accounts	104,848	172,744
Royalties	29,597	29,597
Equipment note installments due within one year less related unearned discount	229,025	87,819
Allowance for doubtful accounts (deduction)	(112,158)	(33,879)
	<u>251,312</u>	<u>256,281</u>
Recoverable federal income taxes — Note F	38,961	90,000
Inventories — at lower of cost (first-in, first-out method) or market	282,447	752,541
Property held for resale — Notes C and E	1,051,771	1,187,232
Prepaid expenses	150,462	272,225
<b>Total Current Assets</b>	<u>1,870,337</u>	<u>3,058,008</u>
<b>Other Assets</b>		
Due from officers and directors — Note J	41,950	226,720
Equipment note installments due after one year less related unearned discount	359,750	329,271
Financing reserves relating to certain equipment notes	94,688	89,535
Prepaid interest applicable to long-term debt	181,066	292,055
Lease and utility deposits and other	136,761	190,958
	<u>814,215</u>	<u>1,128,539</u>
<b>Property and Equipment — on the basis of     cost — Note E</b>		
Land and buildings	950,923	398,955
Leasehold improvements	454,179	545,547
Fixtures and equipment	2,089,849	3,010,968
Allowances for depreciation (deduction)	(580,359)	(587,946)
	<u>2,914,592</u>	<u>3,367,524</u>
<b>Intangibles — Note D</b>	<u>1,318,078</u>	<u>1,696,489</u>
	<u><u>\$6,917,222</u></u>	<u><u>\$9,250,560</u></u>

	December 31 1971	December 31 1970
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Notes payable to bank — Note E	\$ 113,603	\$ 290,824
Trade accounts payable — Note K	438,350	1,052,777
Payable to building contractors	32,100	241,565
Accrued compensation and related taxes	176,473	592,933
Other accrued expenses	477,590	394,086
Franchise and equipment deposits	22,387	23,981
Federal and state income taxes — Note F	—	—
Current maturities of long-term debt	1,120,745	1,467,064
<b>Total Current Liabilities</b>	<b>2,381,248</b>	<b>4,063,230</b>
<b>Long-Term Debt</b> — less current maturities — Note E	1,063,856	1,251,691
<b>Deferred Income</b> — Note A	148,810	112,176
<b>Stockholders' Equity</b>		
Common Stock — par value \$1 a share — Notes B and G:		
Authorized — 5,000,000 shares		
Issued and outstanding (including shares held in treasury) — 1971 — 1,521,765 shares, 1970 — 1,521,765 shares	1,521,765	1,521,765
Additional paid-in capital	2,647,702	2,647,702
Retained earnings — (deficit)	(606,634)	(109,679)
Less Common Stock in treasury — at cost (1971 — 93,550 shares, 1970 — 91,975 shares)	(239,525)	(236,325)
	<u>3,323,308</u>	<u>3,823,463</u>
<b>Commitments and Contingent Liabilities</b> — Notes H and I		
	<u>\$6,917,222</u>	<u>\$9,250,560</u>

See notes to consolidated financial statements.

## Consolidated Statement of Operations

	Year Ended December 31	
	1971	1970
Net sales	\$10,618,730	\$11,020,041
Cost of goods sold	9,839,719	9,702,932
	779,011	1,317,109
Monthly franchise royalties — Note A	281,815	318,396
Initial franchise fees — Note A	78,750	178,835
Other operating income	169,970	137,389
	1,309,546	1,951,729
Selling, administrative, and general expenses — Note K	1,308,299	2,337,107
	1,247	(385,378)
Interest income	10,978	84,799
	12,225	(300,579)
Interest expense — principally on long-term debt	273,336	181,713
<b>Loss Before Income Taxes and Extraordinary Item</b>	261,111	482,292
Federal and state income taxes (credit) — Note F	—	(105,922)
<b>Loss Before Extraordinary Item</b>	261,111	376,370
Extraordinary item — loss (gain) — Note B	235,844	(71,245)
<b>Net Loss</b>	<u>\$ 496,955</u>	<u>\$ 305,125</u>
Per share (based on average number of shares of Common Stock outstanding — 1971 — 1,428,336, 1970 — 1,467,400):		
Loss before extraordinary item	\$ .18	\$ .26
Extraordinary loss (gain)	.17	(.05)
Net loss	.35	.21

See notes to consolidated financial statements.

## Consolidated Statement of Changes in Stockholders' Equity

	Year Ended December 31	
	1971	1970
<b>Common Stock</b>		
Balance at beginning of year	\$1,521,765	\$3,089,614
Issued in connection with acquisitions other than poolings (53,000 shares in 1970) — Note B	—	198,750
Recapitalization from Common Stock without par value to \$1 par value Common Stock	—	(1,766,599)
<b>Balance at End of Year</b>	<u>\$1,521,765</u>	<u>\$1,521,765</u>
<b>Additional Paid-in Capital</b>		
Balance at beginning of year	\$2,647,702	\$ 814,853
Adjustments related to acquisitions — Note B	—	66,250
Adjustments related to recapitalization	—	1,766,599
<b>Balance at End of Year</b>	<u>\$2,647,702</u>	<u>\$2,647,702</u>
<b>Retained Earnings</b>		
Balance at beginning of year	\$ (109,679)	\$ 195,446
Net loss	(496,955)	(305,125)
<b>Balance at End of Year</b>	<u>\$ (606,634)</u>	<u>\$ (109,679)</u>
<b>Treasury Stock — at cost</b>		
Balance at beginning of year	\$ 236,325	\$ 63,747
Sale of certain operating locations for Common Stock (1971 — 1,575 shares, 1970 — 49,525 shares)	3,200	96,781
Foreclosure on certain indebtedness where Common Stock was collateral — 12,400 shares in 1970	—	75,797
<b>Balance at End of Year</b>	<u>\$ 239,525</u>	<u>\$ 236,325</u>

See notes to consolidated financial statements.

## Consolidated Statement of Changes in Financial Position

	Year Ended December 31	
	1971	1970
<b>Source of Funds</b>		
Net loss before extraordinary items — Note B	\$ (261,111)	\$ (376,370)
Depreciation—generally by use of the straight-line method and based on estimated useful lives	341,093	304,505
Decrease in deferred income taxes — Note F	—	33,695
Increase (decrease) in deferred income — Note A	36,634	(73,969)
<b>Total from Operations</b>	<u>116,616</u>	<u>(112,139)</u>
Extraordinary items — Note B	(235,844)	71,245
Decrease (increase) in amounts due from officers	184,770	(112,647)
Decrease (increase) in other assets (principally deposits and prepaid interest)	129,554	(210,908)
Decrease (increase) in intangible assets	378,411	(261,117)
Issuance of Common Stock in connection with acquisition	—	265,000
	<u>\$ 573,507</u>	<u>\$ (360,566)</u>
<b>Application of Funds</b>		
Additions to property, plant and equipment less carrying value of such assets sold or retired (1971 — \$1,173,563, 1970 — \$340,367)	\$ (111,839)	\$1,408,298
Acquisition of treasury stock	3,200	172,578
Decrease (increase) in long-term debt	187,835	(233,518)
Increase (decrease) in working capital	494,311	(1,707,924)
	<u>\$ 573,507</u>	<u>\$ (360,566)</u>
<b>Changes in Working Capital</b>		
Decrease (increase) in current assets:		
Cash	\$ 404,345	\$1,315,832
Receivables	4,969	68,578
Recoverable federal income taxes	51,039	(90,000)
Inventories	470,094	(114,905)
Property held for resale	135,461	(1,187,232)
Prepaid expenses and other current assets	121,763	(70,059)
	<u>1,187,671</u>	<u>(77,786)</u>
Decrease (increase) in current liabilities:		
Notes payable	177,221	459,176
Accounts payable — trade	614,427	(630,727)
Payable to building contractors	209,465	(241,565)
Accrued liabilities	334,550	(583,698)
Federal and state income taxes	—	120,000
Current maturities of long-term debt	346,319	(908,896)
	<u>1,681,982</u>	<u>(1,785,710)</u>
<b>Increase (Decrease) in Working Capital</b>	<u>\$ 494,311</u>	<u>\$ (1,707,924)</u>

See notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

December 31, 1971

**Note A — Principles of Consolidation and Accounting for Franchise Income**

The consolidated financial statements include the accounts of the Company and its subsidiaries. In consolidation, intercompany investments, balances, and significant intercompany transactions have been eliminated. Certain items applicable to 1970 have been reclassified to conform with 1971 classifications.

Initial franchise fees, net of related commissions, have been reported as income when (1) such fees have been collected and the related franchised locations have opened for business or (2) the franchises have expired and the franchisees have forfeited the collected fee and related rights. In some instances, advance and other royalty income has been deferred for recognition during future periods.

**Note B — Acquisitions and Sales of Certain Operations**

During March 1971, the Company and Pizza Hut, Inc. (a non-affiliated Kansas-based company) reached an agreement whereby the Company would be acquired by Pizza Hut. When the agreement was terminated without completion, the Company sold twenty-two operating restaurants to Pizza Hut in satisfaction of its indebtedness for \$400,000 which had been advanced by Pizza Hut during the negotiations. Such sale resulted in a loss of \$206,224. Additionally, the Company sold a sausage plant and twelve operating restaurants considered to be either marginal or located in areas difficult to supervise. Such sales resulted in losses of \$29,620. The total loss of \$235,844 is reflected as a 1971 extraordinary item.

During 1970, the Company purchased ten pizza restaurants for a total of 53,000 shares of its Common Stock and cash of \$45,000 and purchased a frozen pizza business for cash and notes of \$40,000; such operations were included with the Company's since dates of acquisition. Additionally, the Company sold nine operating restaurants. Such sales resulted in a net gain of \$71,245, after applicable income taxes of \$23,000, which amount is reflected as a 1970 extraordinary item.

**Note C — Property Held for Resale**

The Company follows the general practice of leasing its land and buildings; however, the Company owns certain properties which it intends to sell or sell and lease back during 1972. These properties are shown as current assets at December 31, 1971. These and other properties held for resale at December 31, 1970, were not reflected as current assets at that date; however, the 1970 financial statements have been restated for comparability.

**Note D — Intangibles**

At December 31, 1971, intangibles consisted principally of the following:

Purchased rights of Pizza Inns of America, Inc., to which the Company had previously granted the sole and exclusive rights to sell Pizza Inn franchises — approximately \$998,000.

Franchise territorial rights retained in connection with the sale of certain operating locations to Pizza Hut — approximately \$289,000. In the event that rights to these areas are franchised, a portion of the carrying value of such rights will be charged against franchise fee income.

Excess of cost over fair value of assets purchased — approximately \$27,000.

The Company expects that such intangibles will not be amortized against operations so long as they are considered to have

continuing value at least equal to the amounts at which they are carried.

**Note E — Notes Payable to Bank and Long-Term Debt**

At December 31, 1971, notes payable to bank and long-term debt were comprised of the following:

	Due Within One Year	Due After One Year	Total
Notes payable to First National Bank in Dallas	\$ 113,603	\$ —	\$ 113,603 (1)
Long-term debt:			
Deferred trade payables	—	103,573	103,573 (3)
First National Bank in Dallas	407,574	—	407,574 (2)(4)
Other	713,171	960,283	1,673,454 (2)
	<u>1,120,745</u>	<u>1,063,856</u>	<u>2,184,601</u>
	<u>\$1,234,348</u>	<u>\$1,063,856</u>	<u>\$2,298,204</u>

- (1) Land and interim construction notes for Company-owned restaurants; the Bank holds, as collateral, related deeds of trust and a \$200,000 guaranty by the Company's President.
- (2) Generally, five-year equipment installment notes related to substantially all Company-owned equipment and franchisee-owned equipment being financed by the Company. The notes have installment interest included in their face amounts and have, as collateral, security agreements on equipment. In a number of instances, the principal amount of notes applicable to Company-owned equipment is in excess of the Company's depreciated cost therein.
- (3) See Note K with respect to agreement with certain creditors.
- (4) During 1971, the Company experienced a liquidity crisis, and the First National Bank in Dallas accelerated all indebtedness owing to it by the Company. As of December 31, 1971, such acceleration of maturities continues in effect and is reflected above.

**Note F — Income Taxes**

As a result of its 1971 and 1970 operations, the Company has ordinary operating loss carryforwards in excess of \$600,000 and a capital loss carryforward of approximately \$190,000 available for application in future years.

There are certain differences between financial and tax reporting resulting from the use of accelerated depreciation in certain instances for tax reporting, deferral of income from initial franchise fees, and other timing differences. Deferred taxes have not been provided inasmuch as they would be offset by ordinary loss carryforwards.

The Company's balance sheet reflects refundable federal income taxes of \$38,961 at December 31, 1971, relating to amendment of certain prior tax returns. Such refund was received in February 1972.

**Note G — Stock Options**

Stock option plans, both qualified and non-qualified, for officers, key employees, and an option, for 5,000 shares, granted in connection with an acquisition, provide for such options to be exercisable at market prices at dates of grant over a period of five years therefrom. At December 31, 1971, there were Common Stock options outstanding on 91,200 shares at prices ranging from \$1.35 to \$9.00 a share, as follows:

	No. of Shares	Exercise Price Per Share
Qualified Plan	6,000	\$2.125
Non-Qualified Plan	85,200	\$1.35 to \$9.00
	<u>91,200</u>	

At December 31, 1971, an additional 94,000 shares were reserved for future grants under the qualified plan. No options were exercised during 1971.

#### Note H — Commitments

Substantially all of the real property occupied by the Company is leased for terms ranging up to 20 years. Based on leases in effect at December 31, 1971, lease payments for restaurants, warehouses, and offices will be approximately \$1,100,000 during 1972 (including \$134,000 applicable to closed operations); the total aggregate lease commitment amounts to approximately \$15,000,000 (including \$2,300,000 applicable to closed operations). With respect to closed operations, the Company attempts to renegotiate lease terms or sublease the properties where possible; however, in many instances, these are short-term arrangements which do not run for the entire lease term.

#### Note I — Contingent Liabilities

In connection with certain sales of equipment to franchisees, the Company is contingently liable to various financing institutions as the guarantor of franchisees' obligations. At December 31, 1971, such contingent obligation amounted to approximately \$74,500. The Company has also guaranteed the realty lease obligations of certain franchisees; related aggregate rentals amounts to \$793,000 a year and amount to a total aggregate commitment of approximately \$10,300,000 at December 31, 1971.

In connection with a public offering in 1969, a Common Stock Purchase Warrant for 20,000 shares of Common Stock at \$10.80 a share was issued to the Underwriters. The Company agreed that it would file, at its cost, a post-effective amendment to the Registration Statement covering the shares of Common Stock issuable upon exercise of the Warrant which will expire in 1974.

Lawsuits pending or threatened against the Company at December 31, 1971, involved aggregate alleged damages of approximately \$5,500,000. The Company's legal counsel and management believe the suits comprising most of this amount to be without merit or grossly inflated, and further believe the Company's maximum potential losses do not exceed \$350,000 and expect actual losses, if any, will be substantially less than that amount.

#### Note J — Due From and Certain Arrangements With Officers and Directors

Amounts due from officers and directors at December 31, 1971, arose, for the most part, during 1971 as a result of transactions with franchised locations owned either wholly or partially by certain officers and directors. The amount due from the Company's President, Mr. F. J. Spillman, (\$18,386) was paid in February 1972.

Equipment notes receivable includes \$343,209 due from certain officers and directors. Such indebtedness results principally from the sale of nine stores to these individuals in 1970 and 1971, which sales resulted in net gains before income tax effect of approximately \$39,000 in 1971, \$34,000 in 1970.

At December 31, 1970, Mr. F. J. Spillman and his brother, Mr. R. L. Spillman, had indebtedness to the Company of \$226,720. During March 1971, as a \$225,157 payment on that indebtedness, they transferred, to the Company, their equity in certain real estate; the Company operates restaurants on these properties. Such real estate was appraised, by Mr. Wayne Clements, Dallas, Texas, at \$600,235; related mortgage and other indebtedness amounted to \$375,078.

Mr. F. J. Spillman and Mr. R. L. Spillman each hold one of the original "key" franchises issued by the Company. Under this type of franchise, the franchisee has the right to open any number of additional restaurants outside the specified territory or apart from the specified locations without payment of an additional franchise fee so long as the additional locations do not conflict with other franchise arrangements or other operations of the Company.

#### Note K — Arrangement With Creditors

During 1971, the Company experienced a liquidity crisis and entered into an agreement with participating creditors whereby the Company would be extended additional time for the payment of certain trade payables. These deferred trade payables are being paid at the rate of \$20,000 a month; such payments commenced in September 1971, and all scheduled payments have been made timely (\$80,000 paid in 1971, \$60,000 paid through March 15, 1972). At December 31, 1971, \$240,000 of this deferred payable is included in trade accounts payable; the remaining \$103,573 is included in long-term debt (see Note E).

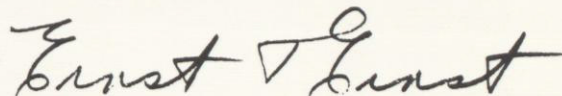
As a result of the aforementioned liquidity crisis, negotiations with creditors, and related matters, the Company incurred substantial extraordinary expenses in 1971. These expenses, principally legal and accounting expenses, amounted to approximately \$170,000 and are included in selling, administrative, and general expenses.

#### Accountants' Report

Board of Directors  
The Pizza Inn, Inc.  
Dallas, Texas

We have examined the consolidated balance sheet of The Pizza Inn, Inc. and subsidiaries as of December 31, 1971, and the related consolidated statements of operations, changes in stockholders' equity, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We made a similar examination of the consolidated financial statements for the preceding year.

In our opinion, subject to the effect of any adjustments that may result from the pending or threatened litigation mentioned in Note I, the accompanying balance sheet and statements of operations, changes in stockholders' equity, and changes in financial position present fairly the consolidated financial position of The Pizza Inn, Inc. and subsidiaries at December 31, 1971, and the consolidated results of their operations, changes in stockholders' equity, and changes in financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.



Fort Worth, Texas  
March 16, 1972

